

Accounting for Receivables

Chapter 9

Wild and Shaw
Fundamental Accounting
Principles
25th Edition

Chapter 9 Learning Objectives

CONCEPTUAL

- C1** Describe accounts receivable and how they occur and are recorded.
- C2** Describe a note receivable, the computation of its maturity date, and the recording of its existence.
- C3** Explain how receivables can be converted to cash before maturity.

ANALYTICAL

- A1** Compute accounts receivable turnover and use it to help assess financial condition.

PROCEDURAL

- P1** Apply the direct write-off method to accounts receivable.
- P2** Apply the allowance method to accounts receivable.
- P3** Estimate uncollectibles based on sales and accounts receivable.
- P4** Record the honoring and dishonoring of a note and adjustments for interest.

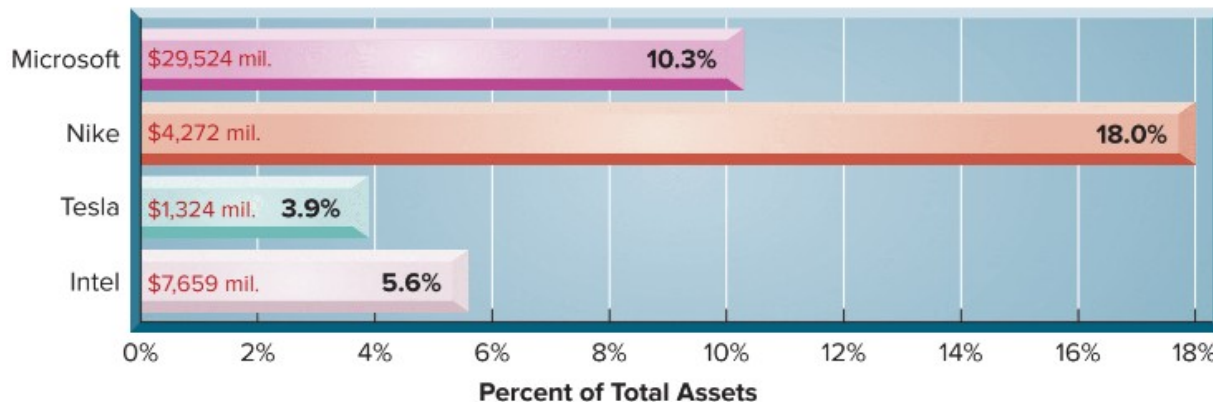
Learning Objective C1

Describe accounts receivable and how they occur and are recorded.

Valuing Accounts Receivable

A receivable is an amount due from another party.

Exhibit
9.1



This graph shows recent dollar amounts of receivables and their percent of total assets for four well-known companies.

A company must also maintain a separate account for each customer that tracks how much that customer purchases, has already paid, and still

Learning Objective C1: Describe accounts receivable and how they occur and are recorded.

OWES.

Sales on Credit: Journal Entries

On July 1, TechCom had a credit sale of \$950 to CompStore and a collection of \$720 from RDA Electronics from a prior credit sale.

July 1	Accounts Receivable—CompStore	950	
	Sales		950
	<i>Record credit sales.*</i>		
July 1	Cash	720	
	Accounts Receivable—RDA Electronics		720
	<i>Record collection of credit sales.</i>		

* We omit the entry to Dr. Cost of Sales and Cr. Inventory to focus on sales and receivables

Learning Objective C1: Describe accounts receivable and how they occur and are recorded.

Sales on Credit: Accounts Receivable Ledger

July 1	Accounts Receivable—CompStore	950	
	Sales		950
	<i>To Record credit sales.*</i>		
July 1	Cash	720	
	Accounts Receivable—RDA Electronics		720
	<i>To Record collection of credit sales.</i>		

Exhibit
9.4

General Ledger				
Accounts Receivable				
Date	PR	Debit	Credit	Balance
June 30		3,000		3,000
July 1		950		3,950
July 1			720	3,230

Accounts Receivable Ledger				
RDA Electronics				
Date	PR	Debit	Credit	Balance
June 30		1,000		1,000
July 1			720	280

Accounts Receivable Ledger				
CompStore				
Date	PR	Debit	Credit	Balance
June 30		2,000		2,000
July 1		950		2,950

TechCom	
Schedule of Accounts Receivable	
RDA Electronics.....	\$ 280
CompStore.....	2,950
Total.....	<u>\$3,230</u>

Learning Objective C1: Describe accounts receivable and how they occur and are recorded.

Sales on Bank Credit Cards

On July 15, TechCom has \$100 of credit card sales with a 4% fee, and its \$96 cash is received immediately on deposit.

July 15	Cash	96	
	Credit Card Expense	4	
	Sales		100
<i>Record credit card sales less 4% credit card expense.*</i>			
*We omit the entry to Dr. Cost of Sales and Cr. Inventory to focus on credit card expense.			

Learning Objective C1: Describe accounts receivable and how they occur and are recorded.

Learning Objective P1

Apply the direct write-off method to accounts receivable.

Bad Debts

Some customers may not pay their account. Uncollectible amounts are referred to as bad debts.

There are two methods of accounting for bad debts:

- Direct Write-Off Method
- Allowance Method

Learning Objective P1: Apply the direct write-off method to accounts receivable.

Direct Write-Off Method - Recording and Writing Off Bad Debts

TechCom determines on January 23 that it cannot collect \$520 owed to it by its customer J. Kent.

Jan. 23	Bad Debts Expense	520
	Accounts Receivable—J. Kent	520
	<i>Write off an uncollectible account.</i>	

Notice that the specific customer is noted in the transaction so we can make the proper entry in the customer's Accounts Receivable subsidiary ledger.

Learning Objective P1: Apply the direct write-off method to accounts receivable.

Direct Write-Off Method - Recovering a Bad Debt

On March 11, J. Kent was able to make full payment to TechCom for the amount previously written-off.

Mar. 11	Accounts Receivable—J. Kent	520
	Bad Debts Expense	520
	<i>Reinstate account previously written off.</i>	
Mar. 11	Cash	520
	Accounts Receivable—J. Kent	520
	<i>Record full payment of account.</i>	

Learning Objective P1: Apply the direct write-off method to accounts receivable.

Using the Direct Write-Off Method

EXPENSE
recognition
principle requires
expenses to be
reported in the
same accounting
period as the
sales they helped

constraint
permits direct
write-off
method if
results
approximate
results using
the allowance

The direct write-off method usually does not best match sales and expenses.

Learning Objective P2

Apply the allowance
method to accounts
receivable.

Allowance Method

At the end of each period, **estimate** total bad debts expected to be realized from that period's sales.

Two advantages to the allowance method:

1. It records estimated bad debts expense in the period when the related sales are recorded.
2. It reports accounts receivable on the balance sheet at the estimated amount of cash to be collected.

Allowance Method - Recording Bad Debts Expense

TechCom had credit sales of \$300,000 during its first year of operations. At the end of the first year, \$20,000 of credit sales remained uncollected. Based on the experience of similar businesses, TechCom estimated that \$1,500 of its accounts receivable would be uncollectible.

Dec. 31	Bad Debts Expense	1,500
	Allowance for Doubtful Accounts	1,500
	<i>Record estimated bad debts.</i>	

Accounts Receivable	
Dec. 31	20,000

Allowance for Doubtful Accounts	
	Dec. 31 1,500

Learning Objective P2: Apply the allowance method to accounts receivable.

Balance Sheet Presentation

TechCom had credit sales of \$300,000 during its first year of operations. At the end of the first year, \$20,000 of credit sales remained uncollected. Based on the experience of similar businesses, TechCom estimated that \$1,500 of its accounts receivable would be uncollectible.

Current assets

Accounts receivable	\$20,000	
Less allowance for doubtful accounts	<u>1,500</u>	\$18,500

or

Current assets

Accounts receivable (net of \$1,500 doubtful accounts)	\$18,500
---	-----------------

Learning Objective P2: Apply the allowance method to accounts receivable.

Allowance Method - Writing Off a Bad Debt

TechCom has determined that J. Kent's \$520 account is uncollectible.

Jan. 23	Allowance for Doubtful Accounts	520
	Accounts Receivable—J. Kent	520
	<i>Write off an uncollectible account.</i>	

Accounts Receivable		
Dec. 31	20,000	
		Jan. 23 520

Allowance for Doubtful Accounts		
		Dec. 31 1,500
Jan. 23	520	

Learning Objective P2: Apply the allowance method to accounts receivable.

Writing Off a Bad Debt

Exhibit
9.5

The write-off does not affect the realizable value of accounts receivable.

	Before Write-Off	After Write-Off
Accounts receivable	\$ 20,000	\$ 19,480
Less allowance for doubtful accounts	<u>1,500</u>	<u>980</u>
Realizable value of accounts receivable	<u>\$18,500</u>	<u>\$18,500</u>

Learning Objective P2: Apply the allowance method to accounts receivable.

Allowance Method - Recovering a Bad Debt

To help restore credit standing, a customer sometimes pays all or part of the amount owed on an account even after it has been written off.

On March 11, Kent pays in full his \$520 account previously written off.

Mar. 11	Accounts Receivable—J. Kent	520	
	Allowance for Doubtful Accounts		520
	<i>Reinstate account previously written off.</i>		
Mar. 11	Cash	520	
	Accounts Receivable—J. Kent		520
	<i>Record full payment of account.</i>		

Learning Objective P3

Estimate uncollectibles
based on sales and
accounts receivable.

Estimating Bad Debts Expense

Two Methods_

- 1. Percent of Sales Method**
- 2. Balance Sheet Methods–Accounts Receivable**
 - **Percent of Accounts Receivable**
 - **Aging of Accounts Receivable**

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Percent of Sales Method

Bad debts expense is computed as follows:

	Current Period Sales
×	Bad Debt %
=	Estimated Bad Debts Expense

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Percent of Sales Method: Example

Musicland has credit sales of \$400,000 in 2021. It is estimated that 0.6% of credit sales will eventually prove uncollectible.

Let's look at recording Bad Debts Expense for 2021.

	\$	4,00,000
×		0.6%
=	\$	2,400

Musicland's accountant computes estimated Bad Debts Expense of \$2,400.

Dec. 31	Bad Debts Expense	2,400
	Allowance for Doubtful Accounts	2,400
	<i>Record estimated bad debts.</i>	

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Percent of Receivables Method

Compute the estimate of the Allowance for Doubtful Accounts which will give you an estimate of Bad Debts Expense.

Year-end Accounts Receivable x Bad Debt %

Bad Debts Expense is computed as:

Total Estimated Bad Debts Expense
- Previous Balance in Allowance Account
= Current Bad Debts Expense

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Percent of Receivables Method: Example

Musicland has \$50,000 in accounts receivable and \$200 credit balance in Allowance for Doubtful Accounts. Five percent of receivables are uncollectible. $\$50,000 \times 5\% = \$2,500$ ending balance.

Allowance for Doubtful Accounts			
		Dec. 31, 2020, bal.	2,200
Current-year write-offs	July 10	1,500	
	Nov. 20	500	
		Unadjusted bal.	200
		Dec. 31 adjustment	2,300
		Dec. 31, 2021, bal.	2,500

Dec. 31*	Bad Debts Expense	2,300
	Allowance for Doubtful Accounts	2,300
	<i>Record estimated bad debts.</i>	

Exhibit
9.7

*The adjusting entry applies our three-step adjusting entry process:

Step 1: Current balance for Allowance account is \$200 credit.

Step 2: Current balance for Allowance account should be \$2,500 credit.

Step 3: Record entry to get from step 1 to step 2.

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Aging of Receivables Method

Classify each receivable by how long it is past due.

Each age group is multiplied by its estimated bad debts percentage.

Estimated bad debts for each group are totaled.

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Aging of Accounts Receivable: Musicland

Exhibit
9.8

MUSICLAND Schedule of Accounts Receivable by Age December 31, 2021						
Customer	Totals	Not Yet Due	1 to 30 Days Past Due	31 to 60 Days Past Due	61 to 90 Days Past Due	Over 90 Days Past Due
Carlie Abbott.....	\$ 5,890	\$ 5,890				
Jamie Allen.....	710			\$ 710		
Chavez Andres.....	10,500	10,300	\$ 200			
Balicia Company.....	2,800				\$1,900	\$ 900
Texas Rawhide.....	9,100		6,110	2,990		
Zem Services.....	21,000	20,810	190			
Total receivables.....	\$50,000	\$37,000	\$6,500	\$3,700	\$1,900	\$ 900
Percent uncollectible.....		x 2%	x 5%	x 10%	x 25%	x 40%
Estimated uncollectible...	\$ 2,270	\$ 740	\$ 325	\$ 370	\$ 475	\$ 360

Each receivable is grouped by how long it is past its due date.

Each age group is multiplied by its estimated bad debts percent.

Estimated bad debts for each group are totaled.

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Aging of Accounts Receivable: Adjusting Entry with Credit Balance

Exhibit
9.9

Step 1: Current account balance equals	Unadjusted balance	\$ 200 credit
Step 2: Determine what account balance should be	Estimated balance.....	<u>2,270 credit</u>
Step 3: Make adjustment to get from step 1 to step 2	Required adjustment	<u>\$2,070 credit</u>

Dec. 31	Bad Debts Expense	2,070
	Allowance for Doubtful Accounts.....	2,070
	<i>Record estimated bad debts.</i>	

Allowance for Doubtful Accounts		
	Unadj. bal.	200
	Req. adj.	2,070
	Est. bal.	2,270

Assets = Liabilities + Equity
-2,070 -2,070

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

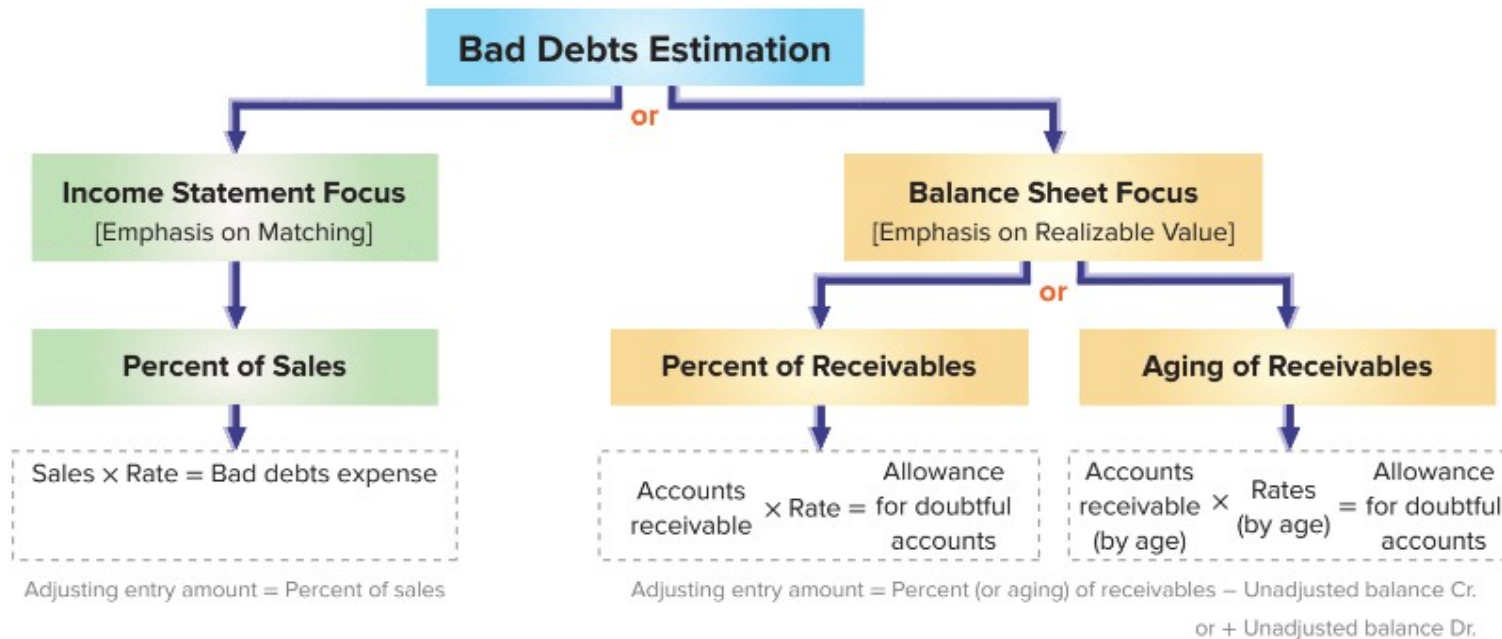
Aging of Accounts Receivable: Adjusting Entry with Debit Balance

Step 1: Current account balance equals			Unadjusted balance	\$ 500 debit	Allowance for Doubtful Accounts	
Step 2: Determine what account balance should be			Estimated balance.....	<u>2,270 credit</u>	Unadj. bal. 500	
Step 3: Make adjustment to get from step 1 to step 2			Required adjustment	<u><u>\$2,770 credit</u></u>		Req. adj. 2,770
						Est. bal. 2,270
Dec. 31	Bad Debts Expense			2,770	Assets = Liabilities + Equity	
	Allowance for Doubtful Account				-2,770	-2,770
	Record estimated bad debts.					

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Estimating Bad Debts - Summary of Methods

Exhibit
9.10



Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Learning Objective C2

Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Notes Receivable

A **promissory note** is a written promise to pay a specified amount of money, usually with interest, either on demand or at a stated future date.

Exhibit
9.11

Promissory Note

Amount: \$1,000 **Date:** July 10, 2021

...Ninety days... after date I promise to pay to the order of

TechCom Company
Los Angeles, CA

One thousand and no/100 ----- Dollars

for value received with interest at the annual rate of .12%...

payable at First National Bank of Los Angeles, CA

Julia Browne

Principal
Date of note
Due date
Payee
Interest rate
Maker

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Computing Maturity Date

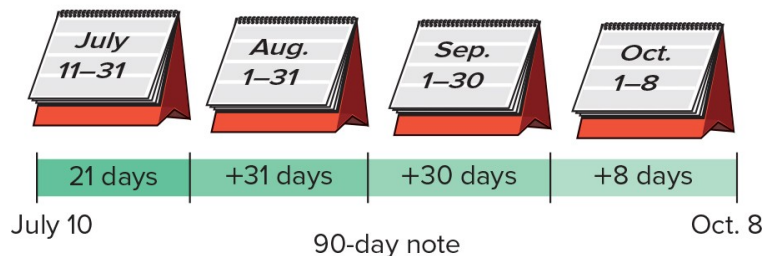
The maturity date of a note is the day the note (principal and interest) must be repaid.

Exhibit
9.12

On July 10, TechCom received a \$1,000, 90-day, 12% promissory note as a result of a sale to Julia Browne.

EXHIBIT 9.12

Maturity Date Computation



The note is due and payable on October 8.

Learning Objective C2: Describe a note receivable, recording of its existence.

Days in July	31	
Minus the date of the note	<u>10</u>	
Days remaining in July	21	← July 11-31
Add days in August	31	← Aug. 1-31
Add days in September	30	← Sep. 1-30
	—	← Oct. 1-8
	<u>8</u>	
Period of the note in days	<u>90</u>	

Interest Computation

Principal of the note	×	Annual interest rate	×	Time expressed in fraction of year	=	Interest
------------------------------	----------	-----------------------------	----------	---	----------	-----------------

Exhibit 9.13

Even for maturities less than one year, the rate is annualized.

If the note is expressed in days, base a year on 360 days using the “banker’s rule.”

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Recording Notes Receivable

Notes receivable are usually recorded in a single Notes Receivable account to simplify recordkeeping.

The original notes are kept on file, including information on the maker, rate of interest, and due date.

To illustrate the recording for the receipt of a note, we use the \$1,000, 90-day, 12% promissory note from Julia Browne to TechCom. TechCom received this note at the time of a product sale to Julia

Browne

July 10*	Notes Receivable	1,000
	Sales	1,000
	<i>Sold goods in exchange for a 90-day, 12% note.</i>	

*We omit the entry to Dr. Cost of Sales and Cr. Inventory to focus on sales and receivables.

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Notes Receivable in Acceptance of Past-Due Accounts Receivable

A seller may accept a note receivable from an account receivable customer to allow an extension to pay a past-due accounts receivable.

To illustrate, assume TechCom agreed to accept \$232 in cash along with a \$600, 60-day, 15% note from Jo Cook to settle her \$832 past-due account.

Oct. 5	Cash	232	
	Notes Receivable	600	
	Accounts Receivable—J. Cook		832
	<i>Received cash and note to settle account.</i>		

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Learning Objective P4

Record the honoring and dishonoring of a note and adjustments for interest.

Recording an Honored Note

The principal and interest of a note are due on its maturity date.

J. Cook has a \$600, 15%, 60-day note receivable due to TechCom on December 4.

Dec. 4	Cash	615	
	Notes Receivable		600
	Interest Revenue		15
	<i>Collect note with interest of $\\$600 \times 15\% \times 60/360$.</i>		

Learning Objective P4: Record the honoring and dishonoring of a note and adjustments for interest.

Recording a Dishonored Note

The act of dishonoring a note does not relieve the maker of the obligation to repay the principal and interest due.

J. Cook has a \$600, 15%, 60-day note receivable due to TechCom on December 4.

Dec. 4	Accounts Receivable—J. Cook	615	
	Interest Revenue		15
	Notes Receivable		600
	<i>Charge account of J. Cook for a dishonored note and interest of $\\$600 \times 15\% \times 60/360$.</i>		

Learning Objective P4: Record the honoring and dishonoring of a note and adjustments for interest.

Recording End-of-Period Interest Adjustment: 12/31

On December 16, TechCom accepts a \$3,000, 60-day, 12% note from a customer in granting an extension on a past-due account. When TechCom's accounting period ends on December 31, \$15 of interest has accrued on the note.

$$\begin{aligned} & \$3,000 \times 12\% \times 15/360 \\ & = \$15 \end{aligned}$$

Dec. 31	Interest Receivable	15
	Interest Revenue	15
	<i>Record accrued interest earned.</i>	

Recording End-of-Period Interest Adjustment: 2/14

Days in December	31	
Minus the date of the note	<u>16</u>	
Day remaining in December		15
Days in January		31
Days in February		<u>14</u>

Recording collection on note at maturity.

Feb. 14	Cash	3,060
	Interest Revenue	45
	Interest Receivable	15
	Notes Receivable	3,000
	<i>Received payment of note and its interest.</i>	

$$\begin{aligned} & \$3,000 \times 12\% \times 60/360 \\ & = \$60 \end{aligned}$$

Learning Objective P4: Record the honoring and dishonoring of a note and adjustments for interest.

Learning Objective C3

Explain how receivables
can be converted to cash
before maturity.

Disposal of Receivables

Companies can convert receivables to cash before they are due.

Selling Receivables

Aug. 15	Cash	19,200
	Factoring Fee Expense	800
	Accounts Receivable	20,000
	<i>Sold accounts receivable for cash less 4% fee.</i>	

Pledging Receivables

Aug. 20	Cash	35,000
	Notes Payable	35,000
	<i>Borrow with a note secured by pledging receivables.</i>	

Learning Obj
before maturity.

Learning Objective A1

Compute accounts receivable turnover and use it to help assess financial condition.

Accounts Receivable Turnover

This ratio provides useful information for evaluating how efficient management has been in granting credit to produce revenue.

Exhibit
9.14

Exhibit
9.15

Company	Figure (\$ millions)	Current Year	1 Year Ago	2 Years Ago
Visa	Net sales	\$22,977	\$20,609	\$18,358
	Average accounts receivable, net	\$ 1,375	\$ 1,170	\$ 1,087
	Accounts receivable turnover	16.7	17.6	16.9
Mastercard	Net sales	\$16,883	\$14,950	\$12,497
	Average accounts receivable, net	\$ 2,395	\$ 2,123	\$ 1,693

Learning Objective A1: Compute accounts receivable turnover and use it to help assess financial condition.

End of Chapter 9